

Audit

Report



FINANCIAL ACCOUNTING FOR THE
DEFENSE CONTRACT AUDIT AGENCY

Report Number 98-110

April 10 1998

Office of the Inspector General
Department of Defense

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AOI 00-03-0808

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Acronyms

DBMS	Defense Business Management System
DCAA	Defense Contract Audit Agency
DFAS	Defense Finance and Accounting Service



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

April 10, 1998

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Financial Accounting for the Defense Contract Audit
Agency (Report No. 98-110)

We are providing this audit report for information and use. This audit was performed in response to the Chief Financial Officers Act of 1990 and the Federal Financial Management Act of 1994.

Because this report contains no recommendations, written comments are not required, and none were received.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson, Audit Program Director, at (703) 604-9582 (DSN 664-9582) or Mr. Walter R. Loder, Audit Project Manager, at (703) 604-9534 (DSN 664-9534). See Appendix C for the report distribution. Audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-110
(Project No. 7RF-2024)

April 10, 1998

Financial Accounting for the Defense Contract Audit Agency

Executive Summary

Introduction. The audit was performed in support of the FYs 1996 and 1997 DoD-wide financial statements required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Financial data from the Defense Contract Audit Agency are included in the "Other Defense Organizations" portion of the DoD consolidating financial statements. The Defense Contract Audit Agency received \$326.5 million and \$322.3 million in direct appropriated funds during FYs 1996 and 1997, respectively. The FY 1996 financial statements for the Defense Contract Audit Agency showed \$106 million in assets, \$71 million in liabilities, and \$412 million in expenses. The Defense Finance and Accounting Service Columbus Center provides accounting support for the Defense Contract Audit Agency.

Audit Objectives. The overall audit objectives were to assess required internal controls and compliance with laws and regulations to produce accurate financial statements. We also reviewed selected FY 1996 account balances submitted to the Defense Finance and Accounting Service Indianapolis Center and supporting documentation for FY 1997 transactions and account balances.

Audit Results. The Defense Contract Audit Agency's internal control program was adequate in all areas that we reviewed, except that the Defense Contract Audit Agency was not actively managing overaged accounts receivable and accounts payable. As a result, the Defense Contract Audit Agency's financial statements overstated accounts receivable by at least \$7.8 million and account payable by at least \$5.7 million. The Defense Contract Audit Agency management provided a memorandum to the Inspector General, DoD, dated November 25, 1997, stating that the old accounts receivable and accounts payable will be investigated and that actions necessary to resolve and close the transactions will be taken. See Part I for details.

Management Comments. We provided a draft report on January 30, 1998. Because this report contains no recommendations, written comments were not required, and none were received. Therefore, we are publishing this report in final form.

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Part I - Audit Results

Audit Background

Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, requires Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, "The Federal Financial Management Act of 1994," October 13, 1994, requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. Financial data from the Defense Contract Audit Agency (DCAA) is included in the "Other Defense Organizations" portion of the DoD consolidating financial statements. During FYs 1996 and 1997, DCAA received \$326.5 million and \$322.3 million, respectively, in direct funding. The FY 1996 financial statements for DCAA showed \$106 million in assets, \$71 million in liabilities, and \$412 million in expenses.

Defense Contract Audit Agency Mission. The DCAA performs all necessary contract audits for DoD and provides accounting and financial advisory services regarding contracts and subcontracts to all DoD Components responsible for procurement and contract administration. Those services are provided in connection with negotiation, administration, and settlement of contracts and subcontracts. DCAA also provides contract audit service to other Government agencies when requested.

Accounting and Reporting for the Defense Contract Audit Agency. On October 1, 1992, the Defense Finance and Accounting Service (DFAS) assumed responsibility from DCAA for financial accounting and reporting for DCAA. The DFAS Columbus Center uses the Defense Business Management System (DBMS) to record accounting data furnished by DCAA. The DBMS is an incomplete general ledger accounting control system. The DFAS Columbus Center forwards DCAA accounting and budgetary information to the DFAS Indianapolis Center, which prepares the monthly "Report(s) on Budget Execution" and financial statements for DCAA.

Audit Objectives

The overall audit objectives were to assess required internal controls and compliance with laws and regulations to produce accurate financial statements. We also reviewed selected FY 1996 account balances submitted to the DFAS Indianapolis Center and supporting documentation for FY 1997 transactions and account balances. Appendix A discusses the audit scope and methodology. It also summarizes prior coverage.

Management of Accounts Receivable and Accounts Payable

DCAA was not actively managing overaged accounts receivable and accounts payable. The DCAA internal control program was otherwise adequate in all other areas we reviewed. The overaged accounts were not managed because DCAA did not implement DoD Financial Management Regulation guidance to periodically review the collectability of accounts receivable and the validity of accounts payable. As a result, DCAA financial statements overstated accounts receivable by at least \$7.8 million, and DCAA should deobligate at least \$5.7 million in accounts payable. DCAA provided a memorandum to the Inspector General, DoD, stating that the old accounts receivable and accounts payable will be investigated and actions necessary to resolve and close the transactions will be taken.

Managing Delinquent Accounts

Debt Collection Improvement Act of 1996. Congress recognized the need for Federal agencies to manage debt collection in a prudent and vigorous manner. Consequently, it passed the Debt Collection Improvement Act of 1996, which mandated that Government agencies exercise quick action to recover debts that have been delinquent for more than 180 days. Congress specified that delinquent debts be transferred to the U.S. Treasury for collection.

DoD Financial Management Regulation. DoD Regulation 7000.14R, "DoD Financial Management Regulation," volume 4, January 1995, states that the more delinquent an account receivable becomes, the greater the likelihood that it will not be collected in full. The Regulation defines a delinquent receivable as any receivable that remains unpaid after its due date. The due date normally is considered to be 30 days from the date of invoice or notice of payment due. In the event that accounts receivable are not collectable, DoD Financial Management Regulation, volume 1, key accounting requirement number 3 states that uncollectable accounts should be promptly written off.

The Financial Management Regulation, volume 4, chapters 9 and 10 also prescribe policies and procedures relating to accounts payable. The Regulation specifies that outstanding accounts payable balances should be reconciled annually with the voucher documentation file, and that differences should be researched, and if necessary, the accounts adjusted.

Defense Finance and Accounting Service Columbus Center. The DFAS Columbus Center assists DCAA with managing and collecting accounts receivable. The DFAS Columbus Center mails 30- 60- and 90-day collection letters to the delinquent DCAA customers and accepts payments for DCAA. The DFAS Columbus Center stated that about 80 percent of its collection effort for all customers combined was chargeable to DCAA. Records at the DFAS

Management of Accounts Receivable and Accounts Payable

Columbus Center showed that as of July 31, 1997, \$14.8 million of \$17.9 million, or 674 of 813 open accounts receivable items, more than 180 days old belonged to DCAA.

Management Control Program Guidance. DoD Directive 5010.38, "Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Accounts Receivable and Accounts Payable

Managing Accounts Receivable and Accounts Payable. The DCAA was not adequately managing overaged accounts receivable and accounts payable. On July 31, 1997, the DCAA general ledger trial balance included \$45 million in accounts receivable, and on June 30, 1997, it included \$27.7 million of accounts payable. More than 30 percent of each were more than 180 days old, indicating that the accounts were not current.

Accounts Receivable. The \$45 million of accounts receivable on July 31, 1997, included accounts receivable of \$14.8 million that were more than 180 days old and two accruals for \$4 million each.

Aged Receivables. More than 30 percent of the DCAA receivables were more than 180 days old. Of the \$45 million in accounts receivable, \$14.8 million (32 percent) was for 674 items that were more than 180 days old. We judgmentally selected and reviewed eight delinquent accounts receivable items, valued at \$3.8 million. A review of the supporting documentation showed that the \$3.8 million represented revenue that was never earned; thus, it should be reversed from the accounting records. During the audit, DCAA agreed that unearned revenue should be reversed from the accounts receivable.

The remaining \$11 million was for 666 open accounts receivable items that were more than 180 days old. Some of the open accounts receivable items dated back to FY 1993. We reviewed files of correspondence from DCAA customers regarding open accounts receivable items. The correspondence indicated customers' refusal to pay open accounts for a variety of reasons. For example, customers cited detail was not adequate in explaining the hours charged to jobs; jobs were not requested; and in some cases, customers simply refused to pay for services rendered. In one case that we reviewed, only a payment of \$337 was received on a \$49,000 invoice.

Accrual Reversals. Each month, DCAA accrued and posted an estimated amount of earnings representing its monthly invoices for services rendered. Later in the month, when the actual dollar value of the monthly invoices had been determined, the estimated amount was reversed, and the actual amount of earnings was recorded. On May 31 and July 1, 1997, DCAA recorded two \$4 million monthly reimbursable accruals, for May and June

Management Accounts Receivable and Accounts Payable

1997, respectively. The monthly accruals were not reversed until September 18 and October 17, 1997, respectively. That was approximately 3 and 1/2 months after each reversal should have occurred. Because of a clerical oversight, the September 30, 1997, trial balance was overstated by at least \$4 million.

Accounts Payable. The June 30, 1997, DCAA trial balance amount for accounts payable and claims payable was \$27.7 million. It was supported by the Defense Business Management System backup documentation on the Accrued Expenditures - Unpaid list. The aged list of payables that DFAS Columbus Center provided was composed of 180 transactions totaling \$9.3 million. The \$9.3 million in payables exceeding 180 days was 33 percent of the total outstanding payables of \$27.7 million. We chose 12 payables, valued at \$5.7 million, and attempted to determine whether the claimants considered the billings to be outstanding. We were able to contact 6 of the 12 claimants. The six payables for which we received responses totaled \$4.3 million. Of the six respondees, five stated that the payables were not active. The sixth respondee claimed that the payable, for \$11,410, was still active. However, that claim related to an FY 1993 permanent change of station move, and such moves are limited to a 2-year period with a maximum extension of 1 additional year. Because the funds were obligated in FY 1993, the opportunity to file a claim had elapsed before the end of FY 1996. Consequently, all six transactions that we checked were inactive, and DCAA should deobligate the funds that had been set aside for billings. DCAA initiated action to closely monitor aged accounts payable. Its actions will correct the weaknesses, and prompt reconciliation of accounts payable should make more funds available for use.

DCAA Financial Statements

Status of DCAA Financial Statements. Because it did not closely monitor old billings, the DCAA financial statement account balances overstated accounts receivable by \$7.8 million, including \$3.8 million of revenue that was never earned and \$4 million of delinquent account reversal. The accounts payable were overstated by \$5.7 million, which DCAA should deobligate to resolve the delinquent accounts payable.

Management Actions. In a November 25, 1997, memorandum to the Inspector General, DoD, DCAA stated that it will investigate the old accounts receivable and accounts payable and will take actions necessary to resolve and close the transactions (see Appendix B). Therefore, this report made no recommendations.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We reviewed the year-end trial balances and "Report(s) on Budget Execution" submitted to support the FY 1996 financial statements for Other Defense Organizations and compared that information with the financial statements. We reconciled the differences between the "Report(s) on Budget Execution" and the annual financial statements that DFAS Columbus Center and DFAS Indianapolis Center prepared. DCAA was appropriated \$326 million in FY 1996. The annual financial statements, as issued by the DFAS Indianapolis Center, showed total assets of \$106 million, \$71 million in liabilities and \$412 in expenses.

We reviewed the June and July FY 1997 trial balances. Our audit concentrated on reviewing internal controls associated with DCAA and DFAS accounting procedures related to accounts receivable and accounts payable. On July 31, 1997, the DCAA accounts receivable was composed of 1,070 open items, valued at \$45 million. Of that, 674 open items, valued at \$14.8 million, were more than 180 days old. On June 30, 1997, the DCAA accounts payable was valued at \$27.7 million. Of that, 180 transactions, totaling \$9.3 million, were more than 180 days old.

We judgmentally selected the 10 accounts receivable items with the letters "REIMB" as part of the document number. Of the 10 items selected, 8 were more than 180 days old and valued at \$3.8 million. The other two items were for monthly accruals for May and June 1997, valued at \$4 million each.

We judgmentally selected 12 accounts payable items, valued at \$5.7 million. Of the 12 items selected, we contacted 6 of the claimants with claims valued at \$4.3 million. In addition, we conducted limited tests of the DCAA payroll and property book.

Because this audit was not intended to provide an overall opinion on the reported balances in financial statements, we did not perform comprehensive reviews or statistical sampling of transactions supporting the balances in the DBMS. Also, we did not project the results of our judgmental sampling of account balances.

Scope of Review of the Internal Control Program. We reviewed the adequacy of the DCAA controls over the reliability of financial information, including accounts receivable and accounts payable. We also reviewed management's self-evaluation applicable to those controls.

Use of Computer-Processed Data. We relied on FY 1997 computer-processed data that DFAS Columbus Center generated from the DBMS general ledger database in reviewing the accounts receivable and accounts payable for June and July 1997 without confirming the reliability of the accounting process. The lack of reliable financial information was recognized as a material management control deficiency in the DoD FY 1997 Annual Statement of Assurance and was

Appendix A. Audit Process

further confirmed in Inspector General, DoD, Report No. 97-017 (see the following Summary of Prior Coverage). However, not validating the reliability of the data did not affect the results of the audit.

Audit Type, Dates, and Standards. We performed this financial related audit from August 1 through October 15, 1997. The audit was performed in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. We included such tests of internal controls as were considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available upon request.

Summary of Prior Coverage

Inspector General, DoD, Report No. 97-017, "Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations," October 31, 1996. The report indicates that DCAA received accounting support from an accounting office that had an incomplete general ledger accounting control system. The report did not contain recommendations to DCAA or the supporting accounting office because the systemic accounting system problems identified in the audit report were addressed in the DoD and the DFAS annual statements of assurance.

Appendix B. Defense Contract Audit Agency Memorandum



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

CFA 220.3.4.2

25 November 1997

MEMORANDUM FOR INSPECTOR GENERAL, DoD

ATTENTION: AUD-FA (Walt Loder)

SUBJECT: IG Review of Fiscal Year 1996 CFO Act Statements

At the exit conference of November 14, 1997, reference was made by your staff that many of the accounts payable and accounts receivable on our accounting reports were old. They recommended that the Defense Contract Audit Agency (DCAA) investigate these old accounts payables and receivables, and take whatever actions are necessary to resolve and close the transactions. DCAA concurs with this finding.

To accomplish this task, DCAA will take the following steps: Accounts payable will be more aggressively reviewed and followed up with the Defense Finance and Accounting Service - Columbus Center (DFAS-CO). Each payable over 60 days will be researched to ascertain its status, and corrective actions will be taken on each payable transaction with DFAS-CO.

Like payables, accounts receivables will be analyzed in more detail. An aging will be done, and all old receivables will be analyzed to ascertain their collectability. A redesign of DCAA's Billing System under our FAO Management Information System is currently underway. With this redesign, many of the causes that clients state as reasons for questioning or rejecting bills will be eliminated. DCAA believes this will greatly reduce the number and age of receivables outstanding.

If you have any questions or need additional information, please contact either Ron Padley on (703) 767-2245 or Paul Earley on (703) 767-2219.


Michael L. Koza
Assistant Director, Resources

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Assistant Secretary of the Air Force (Financial Management and Comptroller)
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Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Finance and Accounting Service Indianapolis Center
Director, Defense Investigative Service
Director, National Security Agency
Inspector General, National Security Agency
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House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report.

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